

# **THE TAXPAYER**

S.E. '93

*Promoting the responsible and efficient  
use of tax dollars*

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## **The Story of New Zealand's Debt Crisis**

# New Zealand of the North?

In February, the CTV newsmagazine W5 aired a special one hour segment on New Zealand. The show examined the impact large government debt has had on New Zealand society.

Viewers saw pictures of hospitals selling neon advertising on their roofs to raise extra funds. They saw worn-out used cars pouring out of ships from Japan. They saw a couple forced to live with a malfunctioning sewer system which occasionally spilled sewage onto their front lawn.

As host Eric Malling pointed out, these problems were caused by government overborrowing and large government debts. The W5 segment was popular with a Canadian public increasingly aware of Canada's own debt problem, prompting the network to rebroadcast the program in May.

Comparisons were immediately made to the Canadian problem. Will Canada be forced to take a similar path as New Zealand because of the tax and spend policies of our various levels of government?

"The Taxpayer" and "The Taxpayer Supplement" are published six times a year by the Canadian Taxpayers Federation (CTF). The CTF is a federally incorporated nonprofit organization. Our purpose is to promote the responsible and efficient use of tax dollars and to provide the public with information on government spending and policy.

There is a subscription charge of \$55 to receive "The Taxpayer" and its supplements. Additional donations are also necessary to fund the various research and advocacy activities of the CTF.

For more information write: #105 - 438 Victoria Ave. East, Regina, Sask., S4N 0N7. Phone (306) 352-7199

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## Comparing Canada's debt to New Zealand's

In 1993-94, the federal government expects its total net debt to reach \$491.2 billion. (The actual debt is about \$50 billion higher, but net debt subtracts the financial assets of the federal government). The provinces owe another \$158 billion, which brings the total debt of the two levels of government to nearly \$650 billion.

In contrast, the New Zealand government has a debt of approximately \$33 billion (Cdn). This means that each New Zealander owes the equivalent of \$9,676 (Cdn) on their national debt compared to the average Canadian's share of \$24,000. The debt load of Canadians is nearly 2.5 times higher than New Zealand. The impact of this staggering \$14,000 difference has been somewhat offset by Canada's stronger economy.

What is perhaps more significant is that while New Zealand is headed on a course toward fiscal stability and a stronger economy, Canada is drifting in the opposite direction. Despite calls for restraint, our provincial and federal governments increased spending again this year, with the combined provincial and federal debt jumping by nearly \$53 billion in 1993-94.

## Can the same thing happen to Canada?

Many wonder when the financial crunch that hit New Zealand will happen in Canada. The federal government hasn't balanced its budget in over 23 years, a trend which many realize can't continue.

Well, the day of reckoning finally arrived in New Zealand in 1984. The new government woke up one morning and discovered that nobody would lend it any more money to continue on their extended spending spree. What fol-

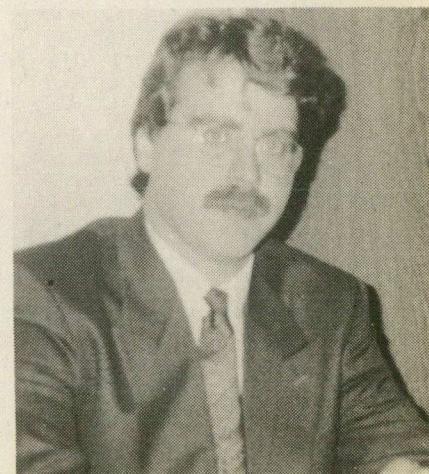
lowed was a credit crisis that provoked a massive restructuring of New Zealand's government and society.

Can this happen in Canada? Some would say no. However, this past spring, significant cracks appeared in Canada's financial base. The Government of Saskatchewan, which has a debt of approximately \$14.7 billion, revealed that the number of international lenders that were willing to lend it money had dropped from 100 to only 25. There were even warnings that, if substantial measures weren't taken to improve the government's fiscal situation, Saskatchewan's bonds would take on junk bond status, with less than ten lenders worldwide willing to take a risk on them.

In 1984, New Zealand found out what it means when a government is unable to borrow money.

Earlier this year, the Canadian Taxpayers Federation (CTF) invited Sir Roger Douglas, New Zealand's former Finance Minister, to Canada as one of the keynote speakers for our Taxpayers Conference.

At the conference, Douglas' insights and experience concerning New Zealand's restructuring were met with enthusiasm. Here was a former Cabinet



Peter Holle

Minister who in a careful and detailed way was providing practical solutions to problems we are facing in Canada.

This past spring, while on other business in New Zealand, Peter Holle, a long-time CTF supporter and private consultant, took an in-depth look at the New Zealand story. He met with several key people in both the private and public sector to examine first hand the massive restructuring of New Zealand's government and economy.

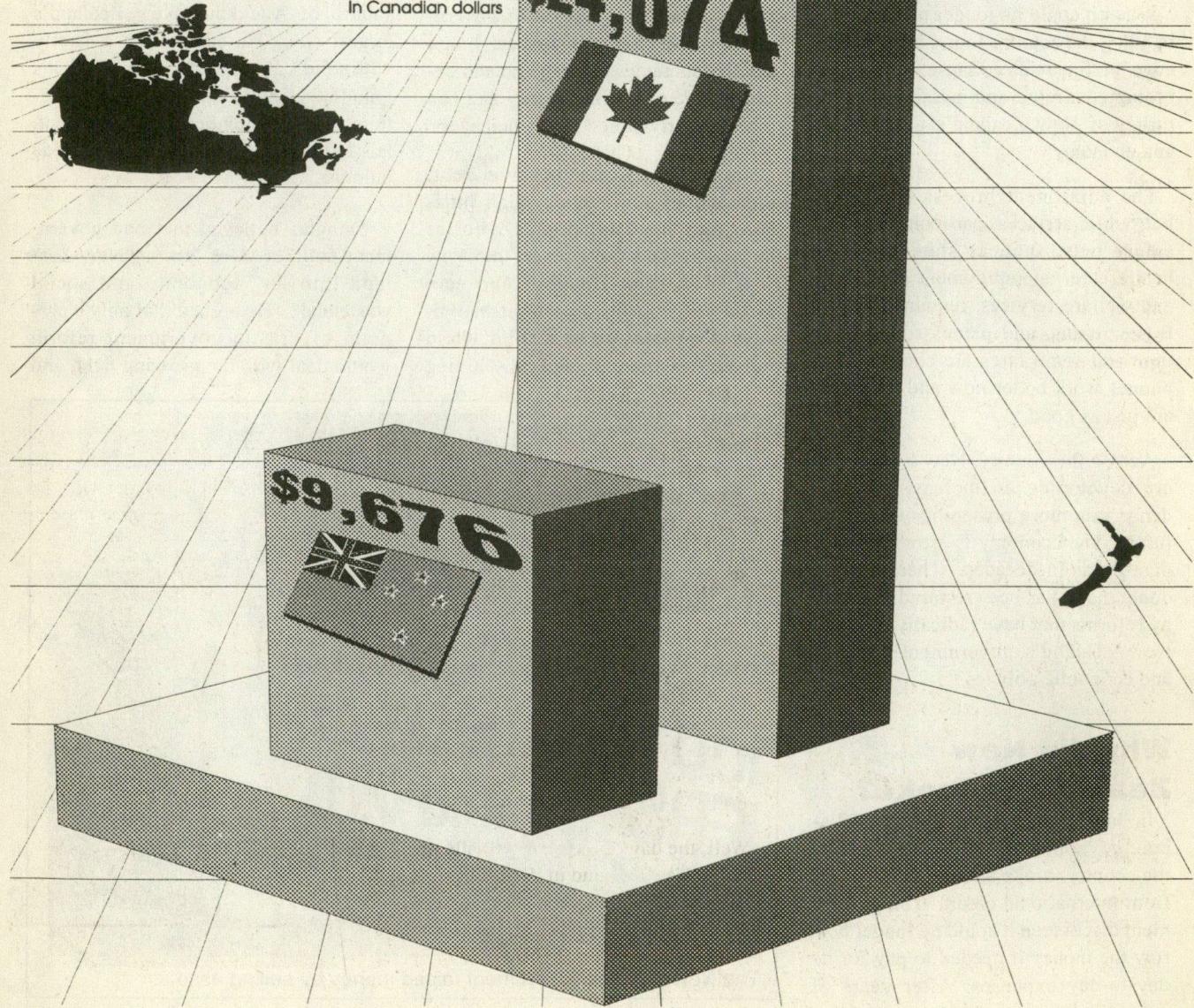
Since his New Zealand trip, Mr. Holle has assumed the position of Research Associate for the Canadian Taxpayers Federation in Winnipeg, Manitoba. We are grateful for his willingness to contribute his insights on these matters to "The Taxpayer" and to the citizens of Canada.

In this special edition, you will see how New Zealand is dealing with their large government debt, piled up during the 1970s and 1980s. You will see the

impact this debt has had on the country's economy and the way the government does business. You will also note the many parallels between New Zealand and Canada. The question we must ask ourselves is what can Canada learn from New Zealand as we address our own debt crisis.

Since this issue of "The Taxpayer" is dedicated to one theme, we decided to try a magazine format instead of our more customary newspaper style.

## **Canadians carry 2.5 times the debt load of New Zealanders - per capita debt**



# The Kiwi revolution

## New Zealand rebuilds after its debt crisis

New Zealand is a relatively comfortable country of 3.4 million people. It has an inventive and well educated workforce, clean, modern towns and cities, and spectacular scenery. A few decades ago, New Zealand had one of the world's highest standards of living. Today, the country's living standard ranks about 30th because government spending, borrowing, and regulation slowed growth.

When it could no longer pay the bills in 1984, the country found itself on the edge of financial collapse. The crisis prompted a rapid and massive restructuring of New Zealand's government and economy.

The adjustment process continues, but public services, particularly social safety nets, such as state-provided health care, unemployment insurance, and welfare services, remain in place. Buses, trains, and planes still run on time and some fares are cheaper. The phones work better now and the roads are just as good.

Across the country, New Zealanders are developing an increasing confidence in a more prosperous economic future. The economy is growing faster than it has in decades. There is little doubt that it has been restored to health by reforms that have radically changed New Zealand's government services and economic policies.

### Why did New Zealand go broke?

In July 1984, the newly elected Labour government entered office to find the country broke and virtually cut off from international credit. The government discovered it could no longer borrow the money it needed to pay for its day-to-day expenses. After years of

relative stagnation, New Zealand's economy could no longer sustain its massive government sector, growing interest payments, high taxes, government regulations, subsidies, and social programs.

At the time, the government controlled much of the New Zealand economy. Government departments ran the forestry industry, the ports, the transport system, the post office, telephone and power utilities. There were government-owned banks, insurance, hotel, and oil companies. Poorly run and uncompetitive, most lost money and had to be regularly bailed out by taxpayers.

Consequently, its massive debt, plummeting credit rating, high inflation, and a collapsing NZ dollar plunged the new government into New Zealand's worst financial and economic crisis in history. What had always been considered a third world problem was now dramatically hitting

an industrialized nation.

Once cut off by international lenders, the new government had little choice but to begin a drastic overhaul of New Zealand's economy and its public sector.

The person who led the changes was Roger Douglas, an accountant by training. He was first elected a Labour MP in 1971 to represent a working class suburb of Auckland, New Zealand's largest city. He came from a family with solid Labour Party roots. Both his grandfather and father had been long-time Labour Members of Parliament. His father had also been a strong trade unionist.

Douglas believed that bad government policies were turning New Zealand into an "economic and social wasteland". He argued that only a program of drastic government reform would deal with the growing debt, and



The New Zealand government raised money by selling assets.

create conditions for renewed economic growth and opportunity.

From 1984 to 1989, Roger Douglas and a team of committed Cabinet colleagues implemented a wide-ranging program of "structural reform". The program, dubbed by some as "Rogernomics", remains perhaps the most wide-ranging reform program ever at-

tempted by a government anywhere.

## How did Labour sell its reforms?

Many will argue that New Zealand's fiscal emergency was responsible for the Labour government's sweeping reforms. Nevertheless, such rapid, tough and sweeping changes required bold

leadership. The Labour government managed to sell the program by focusing not only on why these reforms were necessary but also on how they would benefit ordinary New Zealanders. The messages put forward by the government included:

- The removal of privileges, subsidies and monopolies certain

# Diary of a loan crisis

## It could happen here.

Richard Prebble was the Associate Finance Minister of New Zealand from 1984 to 1989. He told CTV's W5 program what it was like to suddenly find out the country was no longer able to borrow money on the international markets. He recalled: "In comes the Secretary of the Treasury, the Governor of the Reserve Bank, and then you start off by saying 'Well, why have you stopped all foreign exchange dealings?'"

The answer shocked him. The change in government, when the Labour Party assumed power from the previous government, caused international bond traders and credit reporting agencies to take a second look at New Zealand's books. What they saw prompted them to refuse any more credit to New Zealand's overextended account.

Prebble's next question was certain to dispel any doubt as to how bad things really were. He asked the Governor "Well, when's our next overseas loan due?" The answer -- the next Wednesday, and there was no money to pay the bill when it came due.

For those who think the same thing can't happen here, consider this: At any given time, when the Government of Canada borrows money, it is usually doing so to pay for another debt. It's like taking a cash advance from Visa to pay Master Card. New Zealand found out what happens when you are refused credit -- you can't make payments on your previous debt, and the whole house

of cards comes crashing down.

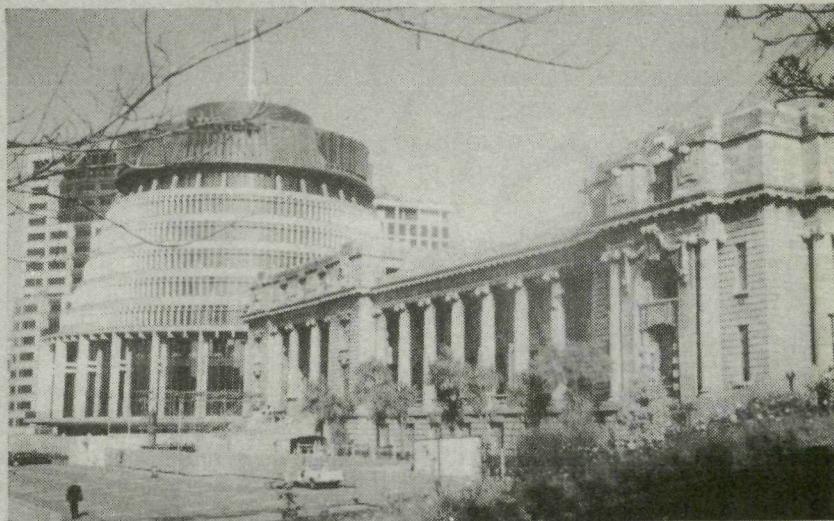
As Prebble noted on the program, when a country defaults on one loan, it defaults on them all. And a government in default is a government without many options. "It means our credit will be blown everywhere we're trading. We'd be basically a basket case."

The Prime Minister of the day, David Lange, recalls contacting each of the country's embassies around the world to see how much cash they could scrounge up from their local banks -- a situation akin to breaking open the children's piggy banks to try to make the mortgage payment. Clearly something had to change.

The choice the government had to make was set out starkly by Richard

Prebble. By way of example, while alluding to the debt ridden national railway system, he said, "No one owes New Zealand a living, and we've got to make a choice. Should we run a railway and be a railway museum, or are we going to run a country? We decided to run a country."

Prebble's only regret? That somebody hadn't made that choice much sooner. "If it hadn't have been for our ability to borrow, we would have tackled these problems twenty years ago. I wish previous governments, including my own party when it had been in office, instead of borrowing, had said to the country, 'Look, fellows, we've got to bite the bullet, and we all know what has to be done.'"



New Zealand: First industrialized nation to come face-to-face with a debt crisis. Above - Part of the New Zealand Parliament buildings affectionately called "The Beehive" located in Wellington.

groups had acquired through past policies, putting all New Zealanders on an equal footing.

- Deregulation and competition created equal opportunity for all. It also meant lower prices. Lower

prices meant a higher standard of living for ordinary New Zealanders.

- Privatization, by fostering efficiency, lowered costs and paid down the debt. Lower costs

meant these companies were more competitive and would grow, not shrink, over time. By paying down debt, privatization lowered interest payments and freed money for necessary social expenditures and further debt reduction.

- By managing taxpayer resources and assets more efficiently, the government liberated resources for other socially useful purposes.
- Lower inflation meant lower interest rates which in turn meant new investments and new jobs.
- The best way to help the disadvantaged was to create a growing economy that produced more jobs and opportunities.
- It could help New Zealanders by pursuing policies which supported the common good, and not the interests of a select few.

## New Zealand makes large strides in competitiveness

What was the New Zealand economy doing last year while Canada struggled under the recession? Well, for one thing, New Zealand was passing Canada in a crucial area -- international competitiveness.

According to the Organization for Economic Co-operation and Development (OECD), out of the 22 most developed economies in the world, New Zealand went from 15th to eighth place, the fastest advance of any country in the so-called "rich nations club".

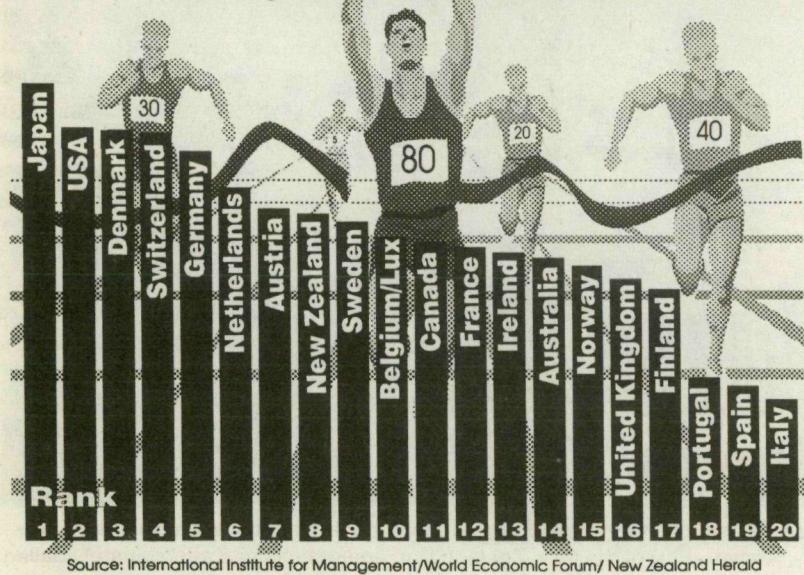
The competitiveness measure is

taken by examining 371 criteria, including inflation rates, growth of GDP, domestic economic strength, infrastructure, education, and the optimism of the business community. In fact, New Zealand business people are an optimistic lot, ranking second worldwide.

While Canada is making up its mind whether it can afford to cut government spending and its interference in the economy, countries that have already reformed their systems are starting to reap the dividends, at Canada's expense.

## World competitiveness scoreboard

New Zealand's competitiveness jumps from 15th to 8th  
Moving ahead of Canada in 1993



Source: International Institute for Management/World Economic Forum/ New Zealand Herald

In short, Rogernomics was about creating wealth and opportunity for ordinary citizens. It aimed to create a foundation for a successful market-oriented economy where low inflation and growing investment created good jobs for everybody.

The massive reforms introduced by the Labour government proved popular with the New Zealand people. In 1987, the voters re-elected the Labour government with an increased majority.

## No turning back

New Zealand's economy slowed with the global stock market crash in late 1987 and the recession in Australia, New Zealand's major trading partner. As the deficit worsened and unemployment rose, a split developed between the reformers in the Labour Party and its more traditional vested interests. Prime Minister David Lange began to talk of the need to take a "tea break" after all the change.

In early 1988, Prime Minister David

Lange shelved Douglas' latest reform package which included a simple, low 23% flat income tax and a guaranteed income plan to protect the poor.

This decision eventually tore the Labour Party apart. Roger Douglas, the leader of the reform group inside the Labour Party retired from politics in 1990. That same year, with its credibility gone, the Labour Party lost the New Zealand general election.

However, the newly elected National Party government continued the reforms started by the Labour government, though it slowed down the rate of privatization. It changed trade union legislation and renewed efforts to control government spending, choosing to control the deficit through restraint instead of by more taxation. In July of this year, bold new health care reforms that introduced competition into the health care system took effect. Welfare reforms now make payments conditional upon seeking work.

In contrast to Canada, New Zealand is well on its way to a more prosperous future. The public realizes there is no

turning back to the days of government owned companies and fat subsidies for everyone and everything, all of which

ing management and infrastructure. The country ranked first in the world among developed countries in the category measuring the quality of government policies.

Today, international investors snap up New Zealand bonds. Inflation is less than 2%. While unemployment is high by past standards, the economy now creates real jobs in the private sector without government subsidies. International corporations,

particularly Australian companies, are moving in to enjoy lower taxes, transportation, and telecommunication costs.

were paid for by growing debt.

In its annual survey of world competitiveness published by a group called the World Economic Forum, New Zealand was the star performer. The survey, which combines published data and executive opinions, saw the country's competitiveness ranking soar from 15th to eighth place based on New Zealand's strengthening economy, and its improv-

Although the country still has a deficit, the trend is down with a balanced budget projected by next year. Many observers agree that New Zealand is on the path to sustainable long-term growth. Its stable prices, increasingly competitive business climate, and productivity-oriented public sector now attracts job creating investment.

In New Zealand, you still find the opponents of change. Some academics and interest group representatives join the occasional politician to champion the failed ways of borrow, tax and spend. Interestingly, some people refer to them as the "Old Zealanders." However, the "Old Zealanders" are becoming a smaller, increasingly curious element in New Zealand society.

With its deficit under control and its economy growing again, New Zealand's future looks bright. The Kiwi revolution continues.



Police cars: Sponsored by local businesses.

#### Please note

All dollars quoted in the following articles are in New Zealand dollars unless otherwise noted. One Canadian dollar is worth 1.4 New Zealand dollars.

## The sun sets on the privileged classes of New Zealand



Kapiti Coast, New Zealand

by Kevin Avram

The first time I sat through a speech delivered by Roger Douglas, the former New Zealand Minister of Finance, I didn't immediately realize the magnitude of what he was saying. He spoke about restructuring, he mentioned efficiency in government, and he used all the other buzz words and phrases which we in Canada have become so familiar with.

As I was fortunate enough to hear him speak on these issues a second, and then a third time, I began to recognize the magnitude of what New Zealand had done. And, although he didn't directly say it, what it amounted to was that New Zealand had, in many ways, charted a course which other nations, including Canada, will have no choice but to eventually follow.

Douglas himself is an interesting man, and in a North American sense has a most unusual perspective on issues. He calls himself a socialist, but if he were to voice his economic ideas in the socialist circles of North America, I suspect he would immediately be hoisted out of the Party. He has long and impressive credentials as a labour representative, and the democratic-socialist roots in his family go back several generations.

What I find so likeable about him is that he's out for the ordinary person. He objects to unearned privilege, and, along

with his economic reforms, has made the elimination of privilege one of his priorities.

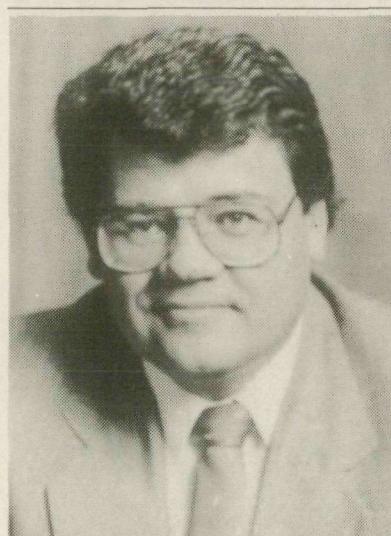
To best understand what he means by privilege consider the following: At a conference here in Canada not all that long ago, Douglas had a bit of a confrontation with a senior labour leader. The conference he attended was on the subject of privatization, and how governments could be made to be more efficient and more responsive to taxpayers if competi-

tion, and in many cases privatization, were introduced.

This Canadian labour leader was angry that Douglas, a former representative of a Labour government would come to Canada in order to promote ideas which would result in less government and fewer unionized government employees. When confrontationally asked why he would do such a thing, Douglas' response was quick, and very pointed. He said, "The answer is very simple. The reason I promote competition in service delivery is because I am a socialist, and I don't believe in protected, or privileged classes."

The point Roger was making is that the labour leaders who were picketing outside that conference were part of a protected class. Although these particular union picketers were presenting themselves as the protectors of the underprivileged, the truth is that the vast majority of people who were paying for their wages, benefits, and job security, (namely taxpayers) didn't have access to the same privileges and benefits which they enjoyed as government workers.

In this edition of the *Taxpayer*, we get the chance to read in considerable detail exactly what Douglas and his colleagues did in New Zealand. It is a most interesting and thought provoking story.



*Kevin Avram is the founder and former CEO of the Canadian Taxpayers Federation. He currently resides in Regina, and in addition to working with various taxpayer associations outside Canada, he continues to do work with the CTF in the area of expansion and development.*

## **Privatization of government companies provides More tax revenues, better service, lower prices**

At one time, the New Zealand Post Office delivered more than the mail. As a government department, it provided banking, telecommunications, and postal services. In 1987, the Post Office department delivered the country's taxpayers a \$63 million loss.

The same year, the New Zealand government converted the department into three different companies: the Post Office, New Zealand Telecom, and the Post Bank. In 1989, the government received \$678 million by privatizing Postbank. In 1990, it sold New Zealand Telecom for \$4.25 billion.

For now, the government still owns the Post Office because government policy focuses on the wider benefits of lower prices and efficiency available in a competitive market place. It will not transfer a monopoly state-owned enterprise to the private sector until a competitive environment has been established.

What have these measures meant for New Zealand taxpayers? First, the two privatized companies no longer drain money from the public purse. They now contribute to it through a 30% tax on their profits.

In four years, profits at New Zealand Telecom increased so much that it paid out twice as much in taxes as it made in total profits in 1988.

Each privatized company now manages its own pension plan, ending the drain on tax dollars from unfunded liabilities. The government used the \$5 billion gained from the sale of the two companies to pay down government debt.

The big winner has been the New Zealand economy. While the work force at New Zealand Telecom has fallen more than 50%, from 27,000 to 13,000, today over 500 new companies now operate in the telecommunications

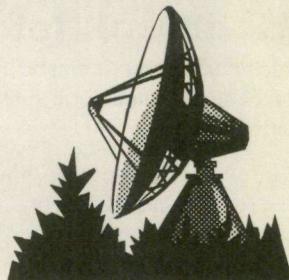
sector, employing over 30,000 people.

At the same time, consumers and the overall economy have benefited from lower telecommunications prices and better service.

Deregulation has improved the types of services offered and the new owners of Telecom have invested more than \$2.5 billion in new technology.

The three companies that once made up the Post Office no longer cost the taxpayers any money. They are now healthy, profitable companies that contribute to the economy.

They are no longer a drain on New Zealand taxpayers - they have become taxpayers themselves.



### ***Moving to the new economy***

*"Employment in the telecommunications sector went from 27,000 in a government monopoly company to over 30,000 today in a sector with 500 to 600 operating companies. Because of deregulation the volume and types of service have improved enormously and prices are half of what they were. This has benefited the economy significantly since lower prices and better services make the New Zealand business community more competitive." - Dr. Peter Troughton, former CEO of New Zealand Telecom.*

The government sold Air New Zealand for \$660 million (NZ).

# Labour's reform program

Between 1984 and 1990, New Zealand's Labour government drastically overhauled the country's economy and changed the way the government sector operated. It reformed and simplified taxation, cut regulations and ended

many subsidy policies.

The government introduced free trade with neighboring Australia. It made the public sector more efficient and performance oriented, and many government-owned companies were sold to

reduce debt. Altogether, there were close to one hundred changes.

The following provides a brief summary of the reforms undertaken by the Labour government of New Zealand during that time.

## Tax reform

- The Labour government replaced a number of sales and excise taxes with a single goods and services tax. To keep it simple, there were no exemptions. Even items like groceries were subject to the GST. To offset the cost for lower income groups, the government introduced a tax credit for those with low incomes.
- The government gained public acceptance for the GST by cutting income tax rates in half - a trade-off popular with the NZ public. It also simplified the tax system by eliminating various tax shelters and breaks. Less complexity meant lower administration costs.
- The reforms increased incentives for people to work, invest, and create jobs - an important requirement for increasing economic growth.

## Agricultural Reform

- Due to the country's financial crisis, the government was forced to eliminate farm subsidies and price support programs.
- While prices decreased, input costs have also declined. The cost of land fell sharply. Production costs fell sharply when the government removed tariffs on farm inputs and agricultural machinery. Port handling, shipping and trucking costs declined when the government deregulated and privatized the ports and railways.
- All farmers started viewing things based on market values for their products, not on the level of government support. Many were forced to change their farming practices, focusing on quality instead of quantity. For example, sheep farmers concentrated on leaner sheep breeds instead of more fatty traditional breeds. They also diversified into other high return activities.
- The number of farmers declined, but not as much as expected. The government worked with banks to restructure farm financing and help viable farm operations keep going. At the same time, farmers who could no longer maintain viable operations were given financial assistance to enter new careers, thereby breaking their cycle of dependency on government payments.

## Ending Business Programs and Subsidies

- Business subsidies and grant programs were eliminated, and export incentives, subsidy programs, and assorted tax breaks were cancelled.
- The long term economic turnaround underway in New Zealand today is being fueled by a favorable and competitive business climate -- not short term handout and assistance programs.

## Deregulation

*The government deregulated much of the New Zealand economy:*

- It required banks and insurance companies to compete. This lowered mortgage rates.
- The telephone company lost its monopoly when it was sold, and other companies moved in to provide competing services. Prices fell.
- The government removed transport sector monopolies, permitting new bus, trucking, and train services. Port handling and transport costs plummeted for farmers and manufacturers, while service levels improved.
- Licensing restrictions on the taxi industry were removed to permit competition. Taxi fares fell.
- Store hour laws and other trading restrictions were removed, and many liquor laws were abolished. As a result, increased competition improved consumer choices and lowered prices.

## Public Sector Reform

*The government began overhauling what was left of the public sector to make it more accountable to the public and a more efficient user of taxpayer resources:*

- The Labour government introduced the concept of performance measurement into the New Zealand public service. In 1988 and 1989, it began to overhaul management practices in all government departments. These reforms

required departments to define what they do, and then measure their performance against clear objectives.

- After the government abolished centralized hiring practices based on seniority, departments were free to hire the best candidate. Short-term performance contracts were in; the concepts of a job for life, seniority, and centralized wage bargaining were out.
- It replaced traditional government accounting practices with modern, private sector style accounting methods. Departments now had useful financial statements that showed how efficiently, or poorly, they managed taxpayers resources. Since efficiency could now be measured, managers were rewarded for being efficient.
- Departments were free to buy services from the most efficient source, including sources outside the government or the country.
- Since the government can now measure efficiency, it can reward manager and employees accordingly. This bottom-line approach saves taxpayers millions of dollars each year. In a little more than a year the system has reduced spending by NZ \$400 million a year, without reducing service.

## Free trade

- The government signed a free trade agreement with neighbouring Australia. The agreement removed tariffs, quotas, and other restrictions on trade between the two

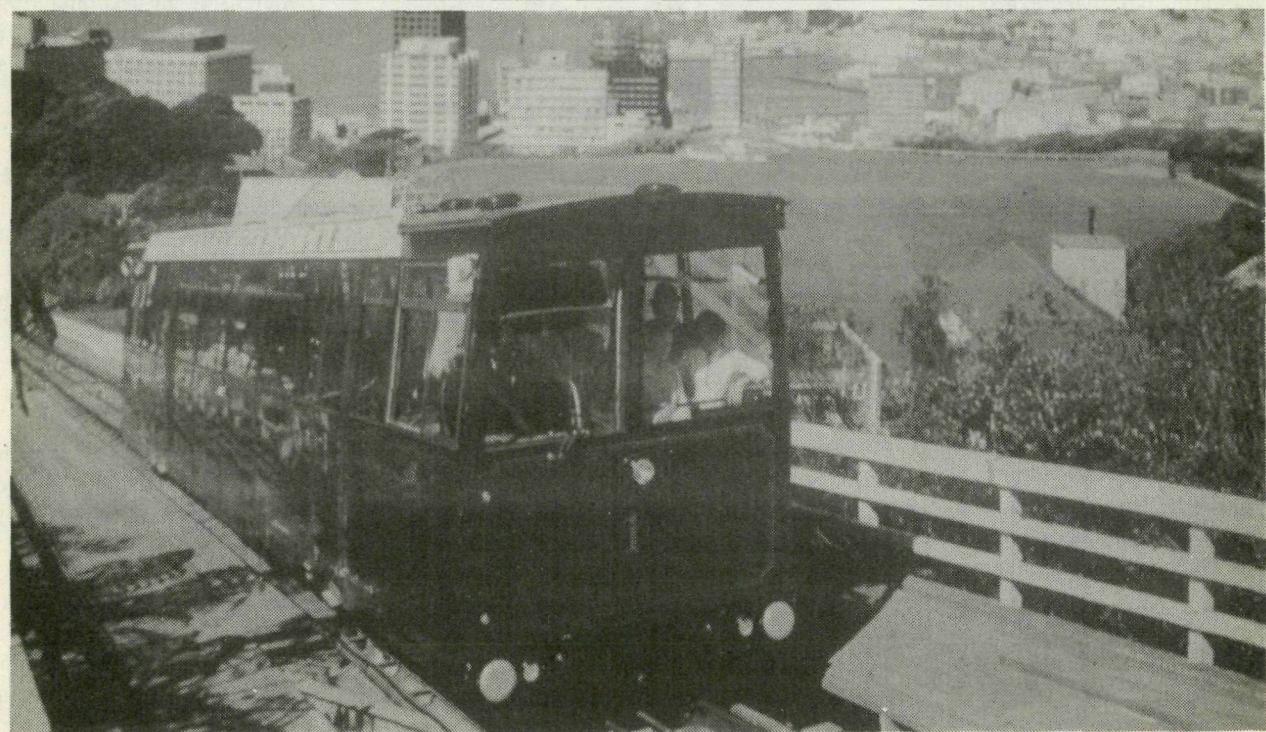
countries. New Zealand's economy has benefited; exports are up sharply, and jobs and investment are shifting to New Zealand's more favorable business climate.

- It removed import restrictions on most products, including food and vehicles. This increased consumer choice and reduced prices.

## Privatization

*Any private company facing financial trouble has little choice but to sell off excess assets to raise money and pay down debts. Countries are no different. New Zealand's debt crisis set the stage for a government-wide sell-off of assets and companies:*

- The government split off commercial activities traditionally done by government departments and reorganized them as businesses in a process it called "corporatization". It then required the new companies, called SOEs or State Owned Enterprises, to pay interest costs (costs of capital) and taxes to the government, and make profits without help from taxpayers.
- To enhance competition and efficiency, corporations such as the telephone company lost their monopoly before they were sold. The companies were advertised internationally to attract foreign investors, and sold to the highest bidder.
- The government used the proceeds from the sales of state-owned companies to pay down government debt.



The City of Wellington sold its bus and trolley system for \$6.5 million. It now contracts out the service and saves 20% over the cost of the previous government system.

## New Zealand health reform introduces

# Competition to control costs

New Zealand's health care system is very similar to Canada's, and has the same problem - rapidly rising costs. Health care costs in that country increased by 20% a year in the early 1980's. Even with a program of government budget caps and other cost cutting measures, costs continued to rise at 12% per year.

What caused New Zealand's health care costs to rise so dramatically? Dr. Peter Troughton, who directs the Crown Health Enterprise Development Unit in the New Zealand government, blames the lack of sound business practices in the system.

According to Dr. Troughton, the New Zealand health care system has the same problem faced by all government organizations: "No financial accountability, spending not directed by normal commercial pressures, empire building, overstaffing, and constant pressure to spend more money."

The government has responded to the problem by introducing a set of reforms that will totally change the way New Zealand's health care system does business. Those reforms begin with a revamping of how the system is funded.

Previously, the country had fourteen health boards which asked for government money and spent it as they pleased. There was no accountability, nor were there any common standards to which they had to adhere.

"The fundamental principle of New Zealand's health care reform is the separation of purchase from the provision of health care," Dr. Troughton said.

Under health care reform, the govern-

ment has replaced the health boards with four regional health authorities (RHAs), and has given each the responsibility of purchasing health care services for the residents in its area. Each Regional Health Authority has been given the mandate to purchase core health care services on a competitive basis.

The government doesn't expect the health care reform package to reduce

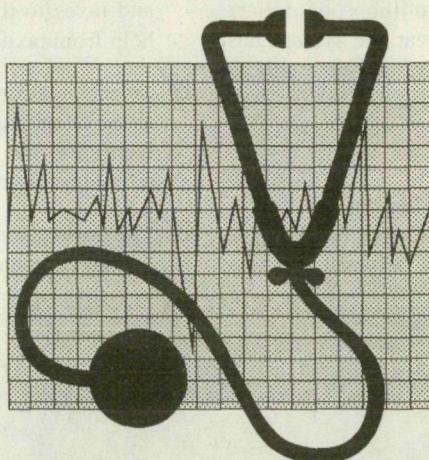
which hospitals performed the best and the worst. No information had been kept to answer this question. Nobody knew. There were no statistics for measuring performance."

Dr. Troughton ordered a study of one particularly well-managed hospital to see whether improvements could be made in other hospitals across the country. A review by an independent panel indicated that the answer was a resounding yes.

The study revealed that savings between 20 and 60% could be realized, without a drop in quality, simply by tendering out such tasks as food catering, cleaning, laundry, printing, and maintenance activities. The study also found that instituting performance evaluations and increasing the accountability of employees significantly improved the efficiency of hospital operations.

What was most significant was the effect that improved efficiency had made on the hospital's ability to perform its functions. For instance, the hospital's operating theatres went from an occupancy of 50% to over 90%. The hospital increased the number of patients it treated in one year from 11,000 to 12,500, and reduced the waiting list by 40%. As a result, the hospital was able to hold the line on its budget, and it turned a half million dollar operating loss into a half million dollar surplus.

Significantly, the study found that the quality of service at this hospital was maintained. In fact, for the first time, a quality measurement system was instituted to allow the hospital to keep track of its performance from the patient's perspective. This hospital became a



the money spent on health care. However, it expects the newly competitive system to become more efficient, allowing the costs of the system to be better managed and controlled. New Zealand is dealing with the problem of inefficient hospitals the way businesses deal with inefficient operations - by measuring how well they are fulfilling their responsibilities. Inefficient facilities will be forced to either change or close.

Dr. Peter Troughton, who is responsible for corporatizing hospitals under New Zealand's health care reform package, found there had been no way to determine how well hospitals were fulfilling their responsibilities. "When I started this project", he said, "I asked

standard by which other hospitals could be measured.

The government corporatized 23 hospitals, running them according to sound business principles. Their new boards were filled with people with strong business backgrounds, and each hospital was given the mandate to operate as a commercial enterprise.

The government will monitor the performance of each hospital, using a set of 25 core standards they are expected to meet. It will require those hospitals that fall short of those standards to account for their failure to meet their performance objectives.

The government will pay the chief executive officers of each Crown Health Enterprise less than the government counterparts they replace, but they can earn a bonus of up to 50% of their salary if they achieve specific performance objectives. The first 20% is earned by reducing the percentage of money spent on overhead and administration with the remainder due if they successfully improve customer service levels, the quality of clinical services,

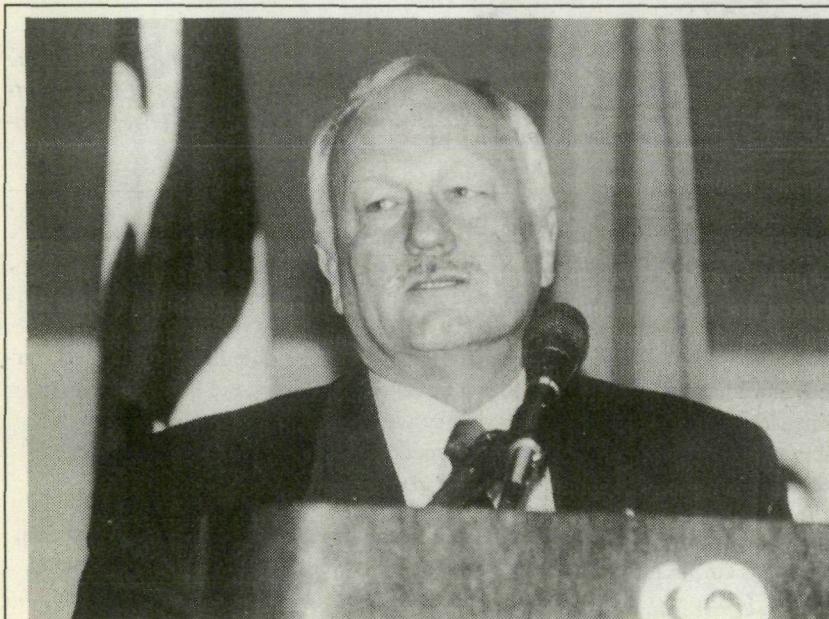
community respect, and accountability.

As Canada struggles with the problem of runaway health care costs, it may be time to closely observe the reforms

in New Zealand. To be effective, health care reform must be accompanied by a commitment to sound business practices, greater accountability, and improved public services.



Selling advertising on top of the Auckland General Hospital pays for a nurse's salary.



Roger Douglas addressing the Canadian Taxpayers Conference held in Calgary earlier this year. Douglas will be in Canada again this fall to deliver a keynote address at the Saskatchewan Taxpayers Conference.

## **The Redundancy Department**

"I'll tell you a story. In '87, at the general election, I went to a public meeting and one gentleman got up and asked me a question. He said, 'Mr. Douglas, I'm a victim of your policy.' So I waited and he went on to say that he had been employed in the forestry department for 15 years and as a result of my policy he had been made redundant. He had taken his redundancy (severance) money and he'd set himself up in business. He said he now employed three people, and wondered when I was going to do it to the rest of the public service?" - Former New Zealand Finance Minister Roger Douglas

# Why government policies drove up farm input costs in New Zealand

New Zealand has been called the "world's largest farm", which reveals the importance of this industry to the New Zealand economy.

Prior to 1973, New Zealand farmers

enjoyed preferential status in the British market. However, this changed when England joined the European Common Market. At that time the New Zealand government began to heavily subsidize New Zealand farmers to keep

them on a competitive footing with other subsidized agricultural producers around the world.

When the fiscal crisis hit in 1984, the government was forced to withdraw its financial support from the farming community. What followed was a major restructuring of agriculture in New Zealand.

The farming community quickly adapted to this unexpected loss of support and moved into new areas of agricultural production. Fewer farms closed down than expected, and surprisingly, the smaller family farms made the adjustments better than did many of the larger corporations.

The largest farm group in New Zealand is the Federated Farmers of New Zealand. The following is an interview Peter Holle had with Peter Elsworthy, the organization's Past-President, and Owen Symmans, its Deputy Chief Executive.

Today, New Zealand is one of the world's largest exporter of lamb, mutton, dairy products and beef - all without subsidies.



New Zealand: The "world's largest farm" now survives without subsidies.

**Holle:** During the 1980s, your government basically eliminated subsidies to farmers. The Federated Farmers now supports the policy of little government involvement in the farm sector. Why?

**Elsworth:** Government intervention was doing more harm than good to agriculture. Subsidies were forcing farmers off the land by inflating the cost of land. Lamb was guaranteed to \$1.45 per kg, and the market was returning \$.45, so the subsidy was a dollar. Production went from 29 to 36 million head simply because of the government subsidy. The country could not afford to go on with that level.

**Holle:** What about government intervention in other parts of the NZ economy?

**Elsworth:** Agriculture was running down because of the high level of costs caused by government intervention throughout the economy. We had high processing charges, high transport costs, fixed exchange rates, fixed interest rates, government borrowing, regulated labour markets, tariffs, and wider interventions which were hurting farmers just as much as they were hurting the whole economy. Regulations, overspending, borrowing, and growing government debt were causing high inflation.

We were exporting to countries which had inflation at one, two, or three percent. How could we sell into those markets when our production costs were going through the bloody roof?

**Holle:** If you could give Canadian farmers some advice

*about subsidies, what would you say?*

**Elsworth:** Look very carefully whether subsidies are doing what they are supposed to be doing. When the government cut subsidies here, fewer family farm operators were put off the land. It was the bigger operators that couldn't adjust. Now, farmers have been through a lot of stress, but results of change to a more market-oriented farm economy have been very positive. We, and the greater proportion of farmers, would not want to go back to subsidies.

**Holle:** *Government moves to increase competition in the general economy through deregulation seem to have benefited New Zealand farmers. I have heard, for example, that lower input costs have balanced off the loss of farm subsidies. Can you give a few examples of how competition has benefited your farm community?*

**Symmans:** We had a high cost of infrastructure in New Zealand. Our waterfront (port) costs were very high. The labour market was dominated by union monopolies and funded through compulsory unionism, which won very embracing awards. The government changed that. Overnight we halved the number of people on the waterfront. The people that lost their jobs got very high severance packages. Savings to farmers are estimated to be as great as 60%. The government also removed restrictive road transport rules and deregulated the railway. Farmers shipping butter from remote areas saved \$48 a tonne in transport costs.

**Holle:** *What about your marketing boards? What will happen to them?*

**Symmans:** Our marketing boards will be reformed if not totally eliminated. The boards have monopolistic powers which have acted against the interest of farmers in quite a lot of places.

**Holle:** *Where do you see the next big moves to competition in the New Zealand economy?*

**Symmans:** The most protected, or privileged, areas in the economy are local government, teachers, and the health system. But changes are happening here too. When council wanted to raise rates (property taxes) by 4 and 8%, when inflation was at 1%, people said something was wrong and protested.

**Holle:** *In general, how has the New Zealand farm community adapted to the end of government subsidies?*

**Symmans:** Our farming community is far more commer-

cial - we didn't quite get to the stage of farmers elsewhere, where they are farming the government. Farmers are now far more innovative here than they were with subsidies. New Zealand's wealth is from an innovative farming community and the businesses that surround it. Now that we are freed up from the shackles of high costs that we had around us, you will see more innovation in terms of production techniques and marketing. Our farmers are going to prosper from it. We are now seeing a lot of diversification.

**Holle:** *Did your government help out the farmers who couldn't make a go of it?*

**Symmans:** Yes, to encourage marginal farmers off the land, the government gave them a \$45,000 exit package to start again in another career. It recognized that it was futile to subsidize non-viable farming operations year after year. Fewer farmers than expected have left the land. Those that have left the land are a skilled group - most have been able to re-establish themselves.

**Holle:** *What has happened to New Zealand's Department of Agriculture in the new world of less government involvement in farming?*

**Symmans:** The government downsized its agriculture department substantially because it is stepping back from heavy involvement in the sector. The department has to sell its advice now and compete with private consultants in the marketplace. The department has a two-year government contract. If they don't provide what the market wants, they will close down. There have been significant changes.



Peter Elsworth - Deregulation cut the costs of farm inputs

# "Thinking Big" in New Zealand

The New Zealand government developed a national development strategy to diversify and build the economy, and thereby create jobs. This policy of the 70s and 80s involved politicians picking strategic industries and pouring billions of dollars of aid into high risk ventures through guarantees and hand-outs.

Dubbed the "Think Big" projects, these inevitably became financial disasters for New Zealand taxpayers. The eventual write-offs added billions to the country's debt which will have to be paid off by present and future New Zealand taxpayers. These included such projects as Synfuels, into which the government invested \$2.3 billion and sold for \$80 million in 1990, and NZ Steel, which received a \$2 billion investment and was sold for \$327 million in 1988.

Sound familiar? Unfortunately, po-

litically driven "Think Big" projects have proven popular and just as costly in Canada. From Novatec in Alberta to

Sydney Steel in Nova Scotia, taxpayers continue to watch politicians flush billions of tax dollars down the drain.



*One of Canada's "Think Big" projects - Sydney Steel has received \$1.5 billion in aid, so far.*

## New Zealand's asset sales

The following is a summary of some of the government owned businesses sold by the New Zealand government, including sale price and year sold. (In millions of NZ dollars - \$1 Canadian buys about \$1.4 New Zealand).

New Zealand Steel . . . . .	\$327.2	1988	Maui Gas . . . . .	\$240.0	1990
Petrocorp . . . . .	\$801.1	1988	Telecom . . . . .	\$4,250.0	1990
Health Computing Services . .	\$4.3	1988	Export Guarantee Ltd. . . . .	\$16.3	1990
Development Finance Corp. .	\$111.3	1988	Tourist Hotel Corporation . .	\$71.8	1990
Post Bank . . . . .	\$678.5	1989	NZ Railways Corp. (bus service)	\$17.5	1991
Air New Zealand . . . . .	\$660.0	1989	Housing Corp. Mortgages . .	\$530.0	1991/92
Rural Bank . . . . .	\$550.0	1989	Taranaki Petroleum . . . . .	\$118.8	1992
Communicate NZ . . . . .	\$0.1	1989	BNZ . . . . .	\$850.0	1992
Shipping Corp . . . . .	\$88.6	1989/90	Government Supply		
Landcorp (financial instruments) . . . .	\$77.0	1989/90	Brokerage Corp. . . . .	\$3.2	1992
Forestry Corp. (cutting rights) . . . . .	\$1,393.0	1989-93	New Zealand Rail . . . . .	\$328.0	1993
Government Print . . . . .	\$35.0	1990	Bank of New Zealand . . . . .	\$1000.0	1992
National Film Unit . . . . .	\$2.5	1990			
State Insurance Office . . . . .	\$735.0	1990			

Source: OECD, Globe and Mail, SOE Office, New Zealand Year Book, The Treasury, R.C. Mascarenhas, Corporatization and Privatization

# Air traffic control becomes a business in New Zealand

As part of its drive to turn various government departments into profitable taxpaying corporations, the air traffic control side of the New Zealand Transport Department was converted into an independent business called Airways Corporation of New Zealand. The result - huge savings for the country's taxpayers.

By 1987, the traffic control system had accumulated a \$44 million deficit, and there was no end to the flow of red ink in sight. The federal government was facing a \$230 million bill for a much needed upgrading of the air traffic control system, money it didn't have. The decision was made to privatize the service - turn it over to the private sector - and Airways Corporation was born.

That decision was a good one for the country's taxpayers and the users of the nation's airports. The cost of modernization was reduced by more than 50%, to \$93 million. Instead of buying the system that would produce the most political dividends, Airways was free to

purchase the lowest priced system.

Decisions are no longer based on what would be most politically popular, but rather on what would provide the best service at the lowest price. As a result, the company is more competitive, and better able to offer its services economically.

There are few complaints from the users of the system, as they receive the benefits from the improvements in the way the company does business, brought about by greater accountability.

Before it embarked on its corporatization strategy, the New Zealand government used its departments as an integral part of its employment strategy. After corporatization, with that pressure removed, Airways discovered it can do more with fewer people.

John Mooney, the general manager of Airways Consulting Service, a business unit of Airways Corporation of New Zealand, explains, "We had a transfusion of blood at the top with the

change. Today there is nobody from the old organization at the executive level." Airways virtually eliminated a complete middle layer of administration, and reduced its staff levels from 1,055 in 1987, to 656 today.

Mooney is enthusiastic about what the change has meant for those who remain. Employees are given a sense of control and accountability, which makes their work more interesting and challenging.

According to Mooney, a lot of employees were unable to adapt to the new way of doing things. "The bureaucratic culture, where responsibility ends up with the minister, is totally different than the culture of running a commercial organization that is accountable to external customers and forces."

## What about Canada?

The decision to fund the costs of the system on a user-pay basis meant that those providing the service had to become more accountable to those who were now paying the bill. That accountability has greatly benefited those who use the country's airports.

"User pay means user says," Mooney explains. "In New Zealand, customers drove out inefficiencies in the system once they had to pay for them."

Mooney has strong opinions about how corporatization would work in Canada. He says that pressure is growing for corporatization of this country's air traffic control system, too. "The airlines, controllers, and pilots want it, but a few in the Transport Department oppose it. The tragedy is that \$100 million in costs could be saved, and you would have a better system."



"We modernized the system for \$93 million instead of \$230 million by taking a business approach to it." - John Mooney

## New Zealand's public sector:

# We couldn't measure performance before

New Zealand abandoned the financial management system used by Canadian governments in 1989. It replaced "spend it or lose it" budgeting with a decentralized, bottom line approach that forces departments to operate as efficiently as possible.

Now New Zealand departments know precisely what their costs to produce services are. If cheaper, they can buy services from the marketplace. The government also discourages the misuse, or underuse, of assets by charging departments for the capital invested in buildings, land, and equipment. This discourages waste since departments will sell off un-

needed assets to avoid these charges. (If Canadian departments were charged the cost of capital, taxpayers would see fewer overbuilt airports and extravagant government office buildings, and there would be less valuable government land sitting idle in urban areas).

The following is an interview Peter Holle had with John Chetwin, the Deputy Secretary of New Zealand's Treasury Department, and Brian McCulloch, the department's Manager of Financial Management Policy. New Zealand's Treasury Department is equivalent to Canada's Department of Finance.

**Holle:** Why did New Zealand decide to overhaul the way its departments managed their finances, and how were the changes brought in?

**Chetwin:** In 1984 the new government decided to go with new policies that increased economic growth like deregulation, reducing subsidies, and tax reform. Because the government was such a significant portion of the economy, it turned its attention to making government more efficient.

First, it focused on the commercial areas of government. In 1986 it brought in SOE (state-owned enterprise) legislation, and the main commercial aspects of government were corporatized into SOEs. They operate under the same corporate legislation as the private sector and were required to act in a businesslike manner without government interference.

Second, it brought in financial management reform to improve the efficiency of the remaining public sector - the so-called core public sector. In 1988 it brought in staffing reform to give departments more flexibility in hiring personnel. In 1989 the government brought in financial management reform.

**Holle:** What is financial management reform?

**McCulloch:** New Zealand's financial management reforms are designed to allow the departments the freedom to perform more efficiently. There are four key concepts behind the reforms:

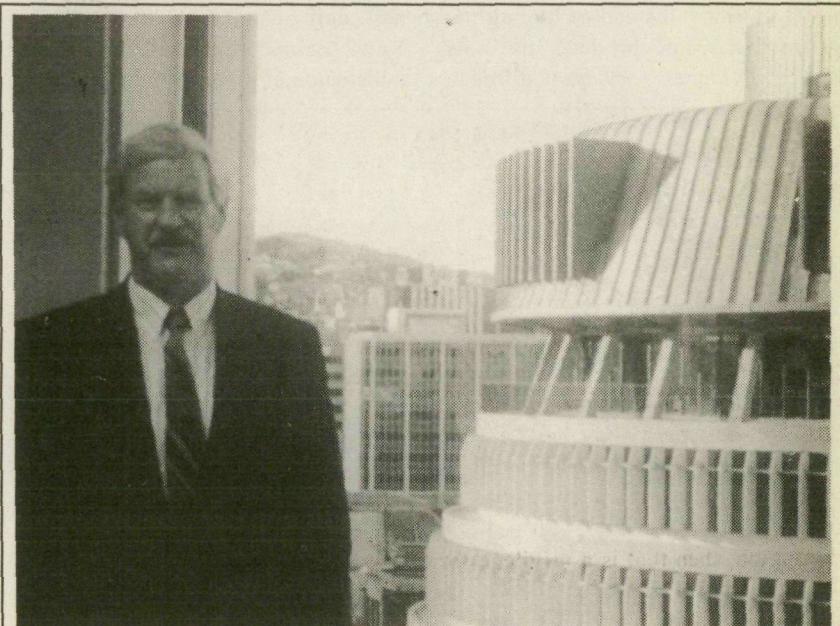
1. Create an appropriate accountability relationship between the de-

partment & the government.

2. Specify in advance what the department's performance will be during the period.

3. Give the department responsibility to control the inputs.

4. Then measure, monitor, and evaluate performance.



John Chetwin: "Nobody else in the world is making such comprehensive changes." - John Chetwin in his office overlooking "The Beehive".

**Holle:** Why is your budgeting system unique?

**McCulloch:** The new budgeting system recognizes that the government has two interests. It has an ownership interest and a purchasing interest.

First, as an owner, the government has significant long term investments in departments. A significant cost of the operations is the cost of capital, and we have made that explicit by implementing a capital charge. We charge the departments based on the net assets invested in the department. Asset charges reflect to departments that there is a cost of capital. Within the net

assets they have, they can sell their assets, buy new ones, and organize their production operations so that they can produce most efficiently without Treasury involvement, unless they want more money.

Second, as a purchaser, the government not only owns these departments but it also contracts with them to supply goods and services. On the purchase side you have the same sort of interest as if you were a customer. You are interested in the quality of the product and how much it is going to cost you.

**Holle:** How do you measure what a

service costs?

**McCulloch:** You need service performance reporting. You need information to measure how efficiently outputs have been provided. The information will show if goods and services can be purchased at less cost from outside the department. This now happens because the system provides information that shows where government can buy services for the best value for its money.

The information is also important for holding the CEOs of departments accountable. Unlike before, we now have information which allows the government to measure the performance of departments.

**Holle:** Is the Treasury less involved in managing the affairs of individual departments?

**Chetwin:** Yes, the Treasury is much less involved in department operations now. Before we had a lot of controls on inputs (the money and staff required to produce a service). It was the same at the State Services Commission. Both the Treasury and the State Services Commission were heavily involved in these controls. The focus is now on what the departments are going to produce, not on what resources will be used. They now have much more freedom to manage without our involvement.

For example, departments now run their own bank accounts. Before, if you were a department and you had an invoice to pay, you sent a voucher into Treasury which paid it. It was all done centrally. Now they all run their own financial management systems. Departments have their own bank accounts. They get a standard bank statement and interest on their account.

With the changes, Treasury shed a lot of functions like superannuation (managing pensions). We used to have regional treasury offices to handle all of the cash processing. They have all closed down.

## New Zealand's reforms were about:

# Getting rid of privilege



"There was obviously some opposition to our changes. I mean, more particularly from those people who had gained privilege from the previous arrangement. I think you'll always get that. I mean, wherever government creates a handout or subsidy, you have a few people getting a huge privilege at the expense of the rest of the population. Now, when you reverse that, these people will obviously complain about their lost privilege. If you've got overmanagement on your wharves, if you've got double the number of people required to do the job, then that is a privilege for the people who work on the wharves. They're probably being paid more than the average person in the country, and they're only doing half the work they should be. So, that's a privilege being paid for by the rest of the public. I think that was what our policy was all about -- getting rid of privilege." - Roger Douglas

**Holle:** Are there standard rates of pay in the new system if departments have more freedom to manage?

**Chetwin:** There aren't standard pay rates anymore. The Director of Finance could be paid quite differently than the equivalent position in other departments. It's up to the department's CEO as the employing authority. Previously it was up to the State Services Commission. Everything was standardized. Now everybody is on an individual contract.

**Holle:** These reforms were started by the Labour government in 1988 and 1989. Did the new government make any changes when it was elected in 1990?

**Chetwin:** When the new government came in 1990 they reviewed these reforms. Nobody had a problem with the changes. Going back to the way we

were before is inconceivable. We have a lot of new people. They just shake their heads in disbelief when they are told what things were like five years ago. They can't understand how you could work like that.

**Holle:** How did you introduce a performance oriented, private sector style accounting system into a traditional rule oriented civil service system?

**Chetwin:** The process of introducing the new system was quite traumatic in some cases. It wasn't a matter of introducing a new accounting system; it was a matter of introducing a whole new management system and a different culture.

We adopted a strategy of ramming through the financial changes as quickly as possible. It would take years to fine tune everything. It was right, though there were a few bruised bodies

in the process. Now people say they are glad it was done this way.

**Holle:** What has been the effect of all these changes on the size of the New Zealand government budget?

**Chetwin:** The changes have achieved a peaking and then a downward trend in government spending as a portion of the economy. Our spending peaked out around 40%. This year we should be at 39%. It's going down now. It should drop down to the mid 30's by 1995.

**Holle:** What is the New Zealand government's approach to taxation?

**Chetwin:** On the tax side the aim has been to try and broaden the tax base rather than raise rates. In the long run the government will want to lower rates, but first we have to start achieving surpluses.

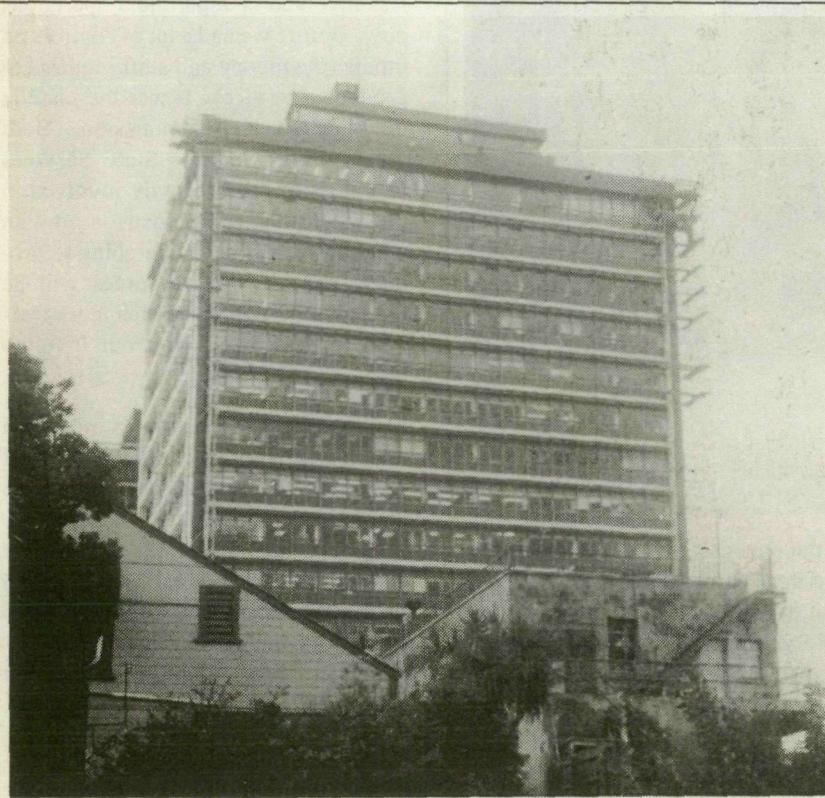
**Holle:** Has all this change been easy?

**Chetwin:** It's been a struggle. Change always is.

## **The business abilities of politicians**

Excerpt from the New Zealand's 1988 Labour Government Budget Speech

"In spite of the considerable productivity gains achieved to date, the returns from the state-owned enterprises are still expected to be well below the market average. Retaining ownership of all these businesses would entail the ongoing risk that a large portion of New Zealand's assets would underperform. The taxpayers would bear the risk of future politicians' pretensions to business management.... Taking the decision to withdraw from ownership of some businesses is a further stride towards enabling government to concentrate on fulfilling its proper role."



With bottom line responsibility, government departments are free to rent, buy or sell their own facilities. Once that happened, many left the high rent districts and moved into less expensive quarters. Above - the former facilities of the New Zealand Works Department.

# Moving to the new economy New Zealand State Owned Enterprises

## Fewer staff

Staff numbers	1987	1988	1989	1990	1991
Coal Corp.	1861	892	806	715	675
Electric Corp.	5999	4424	4066	3950	3974
Forestry Corp.	7070	2652	2547	2597	2572
NZ Post	12,000	9,800	9,500	8,500	8,200
Railways*	14,900	12,500	9,900	8,400	5,900
State Insurance*	1,265	1,198	1,220	1,186	1,114

New Zealand achieved staff reductions through generous severance packages and early retirements. Many former employees now operate their own companies in the same industries.

## Now produce more

Sales (\$NZ millions)	1987	1988	1989	1990	1991
Coal Corp.	NA	\$108	\$103	\$112	\$105
Electric Corp.	NA	\$1,326	\$1,455	\$1,532	\$1,584
Forestry Corp.	NA	\$236	\$293	\$386	\$502
NZ Post	NA	\$579	\$499	\$478	\$501
Railways*	NA	\$667	\$669	\$601	\$349
State Insurance*	NA	\$272	\$256	\$232	\$221

More products and services are produced at substantially less cost. Lower costs have boosted the economy.

## To help the bottom line

After Tax Profits (\$NZ millions)	1987	1988	1989	1990	1991
Coal Corp.	NA	\$4	\$9	\$11	\$9
Electric Corp.	NA	\$196	\$332	\$339	\$404
Forestry Corp.	NA	\$61	\$82	\$138	\$160
NZ Post	NA	\$71	\$31	\$44	\$28
Railways*	NA	-\$148	-\$263	\$2	\$39
State Insurance*	NA	\$69	\$52	\$46	\$24

By increasing the profitability of SOEs, the government can expect a higher selling price when it privatizes each company. The government intends to privatize most of them. \* NZ privatized Telecom in 1990 for \$4.25 billion, State Insurance in 1990 for \$735 million and Railways in 1993 for \$328 million.

## Amount of revenues generated per employee

Performance summary	1987	1988	1989	1990	1991
Average of companies listed above	NA	\$93,000	\$115,000	\$133,000	\$153,000

# Getting on track

## The New Zealand Rail story

New Zealand Rail is an example of a government agency that, through corporatization and privatization, was able to save both its customers and the country's taxpayers a great deal of money.

Prior to 1984, NZ Rail was a bloated bureaucracy with 22,000 staff, protected markets, and a track record of yearly losses. The Labour government reorganized the railway with a clear mandate to operate more efficiently.

As a result, the company hauls as much freight today as it did before

corporatization, while employing less than 40% of its previous work force. While productivity has gone up, freight rates have declined, by more than 50% in real terms over the past ten years. Lower freight rates, in turn, have made New Zealand industries more competitive.

After years of losses, the company made a small profit in 1990. New Zealand taxpayers were no longer on the hook to pay huge subsidies to cover NZ Rail's annual losses. In its 1991 annual report, the company's Managing Director commented that NZ Rail was "the only railway in the

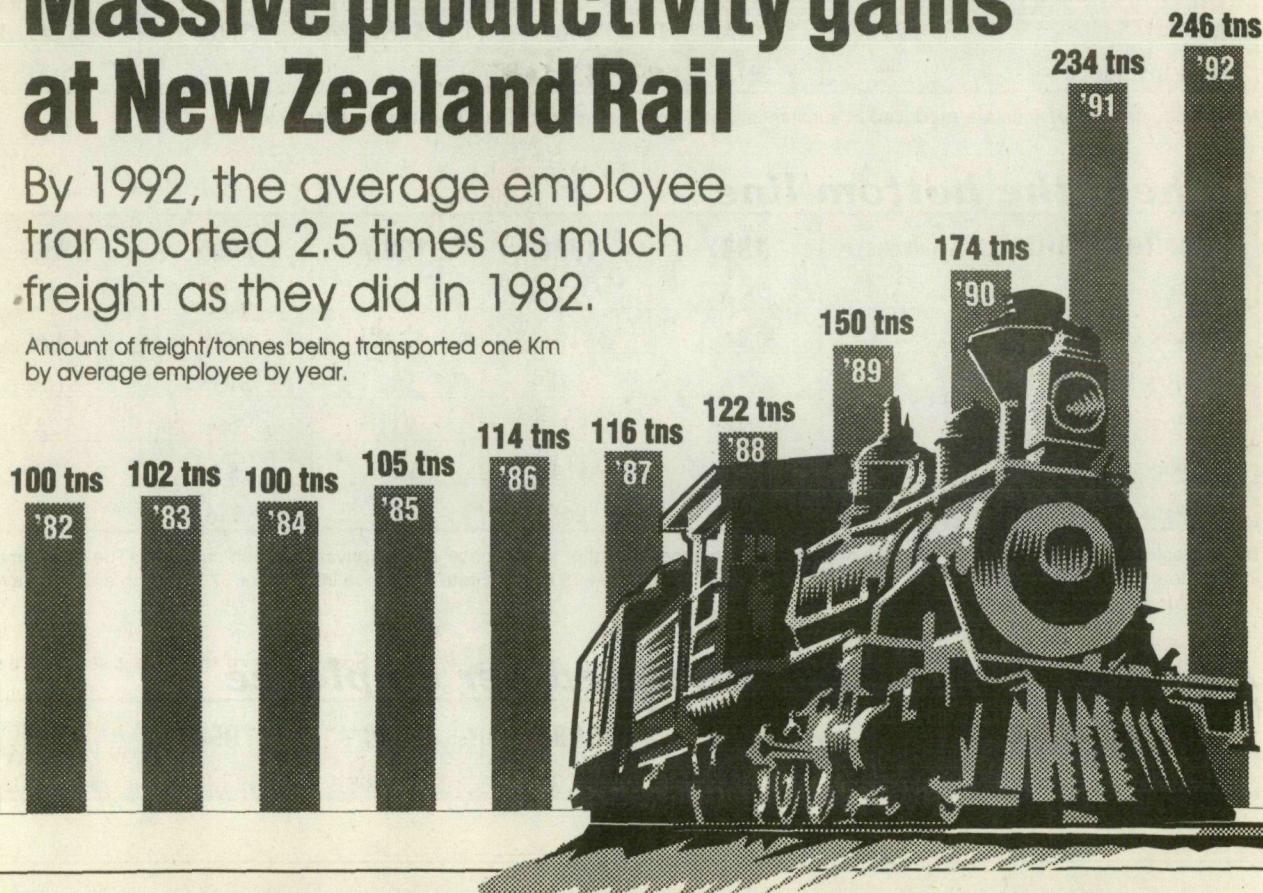
world, outside of the United States of America, to have made a profit last year free of subsidies and operating without protection." Last year the corporation produced a \$40 million dollar profit.

In July of this year, the New Zealand government announced that it had sold its shares in New Zealand Rail. The sale marks the end of a remarkable turnaround in the company's fortunes: It has gone from being a drain on the public purse to being an engine of the economy, generating new wealth for the country and tax revenues for the government.

## Massive productivity gains at New Zealand Rail

By 1992, the average employee transported 2.5 times as much freight as they did in 1982.

Amount of freight/tonnes being transported one Km by average employee by year.



## Interview with Roger Douglas:

# We dismantled privilege where we found it

Roger Douglas was New Zealand's Finance Minister from 1984 to 1989 and the original architect of "Rogernomics" - the wide ranging structural reform program that began the comprehensive and ongoing overhaul of New Zealand's economy and public sector. Retired from politics, Douglas now resides in New Zealand's largest city, Auckland, from where he operates a consulting business.

**The Taxpayer:** During 1984 you began a program of government reform in New Zealand as the Labour Government's new Finance Minister. In a few words, what was it all about?

**Douglas:** In broad terms, the program was about structural change. New Zealand was at a crisis point. Its debt was too high. It had subsidies to farmers and subsidies to manufacturers. It had interest rate controls, exchange rate controls, you name it, rent controls and wage controls. They weren't working. We needed to liberate our economy. We decided to

become outward looking rather than trying to isolate New Zealand from the rest of the world.

**The Taxpayer:** Traditional Labour parties in most countries tend to favour government intervention. As a Labour Government Finance Minister, how did you manage to sell your program of reduced government intervention?

**Douglas:** It was relatively easy. We dismantled privilege where we found it, whether it was subsidies, special incentives to manufacturers, or overmanning

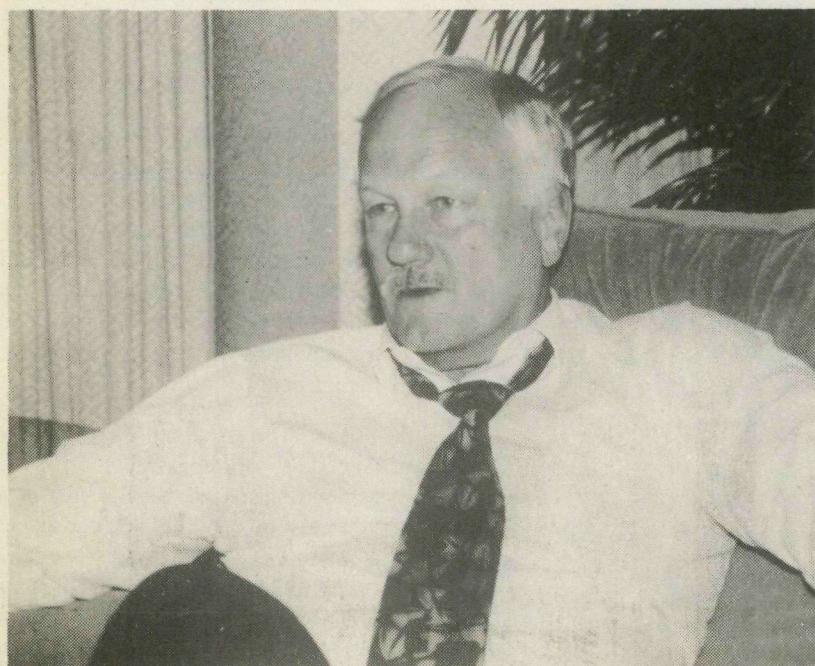
in various parts of our economy, particularly the public sector. We just removed privilege wherever we found it. And it worked. The people re-elected us with an increased majority in 1987.

**The Taxpayer:** Canada has a large structural deficit. Interest payments now make up 35% of federal revenues in Canada. If you were Canada's Finance Minister, what would you do?

**Douglas:** You simply can't go with that level of debt and interest payments for too long. What you have to do is undertake a comprehensive program of structural reform. You need to say that over a period of time you are going to get those interest payments and the level of debt down to manageable proportions. Obviously you can't do it in one or two years but you have to have a program that will accomplish the job, and people have to see that it's practical and deliverable. If people see that it's not going to actually happen, then they won't believe it and won't change their habits.

**The Taxpayer:** You have a new book coming out. What's it about?

**Douglas:** It looks at where the New Zealand economy is now and where it could go in the future. We still have too much debt. We still have a fiscal deficit. Some parts of the public sector are still highly protected - namely education and health. We have a pension system which is causing a real problem for our budgetary situation.



Roger Douglas - "We dismantled privilege where we found it, whether it was subsidies, special incentives to manufacturers, or overmanning...."

# Spending is still too high

Optimism in New Zealand's business community is at its highest level in 21 years according to Roger Kerr, Executive Director of the Wellington-based New Zealand Business Roundtable. The policies of deregulation, lower taxes, and public sector reform have allowed New Zealand to control its budget deficit, government debt and inflation. The country's economy is growing strongly at three to four percent a year, as a result.

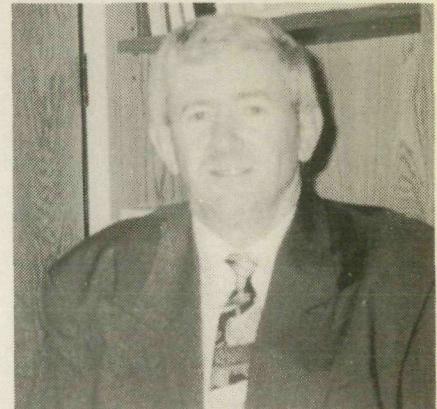
While Kerr was upbeat about New Zealand's positive outlook, he cautioned that there was much more to do. "We still have a serious fiscal problem, a high level of debt and unemployment; government spending is still too high. There is still a need for a shake-out of jobs in areas like the electrical industry and public hospitals to achieve world-class productivity levels," Kerr said.

Kerr attributes the country's past decline to a low public awareness about the country's growing economic predicament. "There was an unwillingness to face up to the disciplines which

would bring us greater success, and susceptibility to the soft options of populist politicians. In New Zealand, the idea that somebody had to pay the bills had become a quaint notion held only by a few spoil sports." He added, "We still hear of people talking about 'free' health services or education. What that means of course is that other people bear the cost."

Government spending programs can confer benefits but they do not come 'free'. Spending programs create costs for the community. He said, "The most obvious ones are the wasteful use of resources in many public sector organizations."

Kerr stressed that governments can't deal with their spending problems by hoping for more growth and by raising taxes. High taxes only slow growth by reducing incentives to work, save and invest. Governments generally waste a lot of money because they are poor managers of resources. Ultimately, he explained, the problem of excessive spending must be addressed by reduc-



Roger Kerr - "New Zealand is still far from being out of the woods."

ing the largely wasted, low quality and poorly directed spending found throughout government.

According to Kerr, investment growth and jobs flow to countries that manage their economies and fiscal affairs well, while keeping their tax burdens competitive. "We are seeing an international competition for quality government administration - at least among those countries striving for growth in income and jobs."

Ultimately, Kerr believes the country should strive to lower government spending to a maximum of 30% of its gross domestic production. Kerr says, "An economy in which government controls over 40% of national income will continue to perform poorly relative to economies with lower tax and spending burdens."

How would Roger Kerr deal with Canada's looming fiscal crisis? "To achieve structural change in Canada, you must do it boldly and consistently. You must explain flat out what you are trying to do and the public will support you. You will have to neutralize the interest groups by demonstrating that they are following agendas that benefit themselves at the expense of everyone else."

## Downtown Auckland



Business optimism at its highest level in 21 years.

## New Zealand government

# Cancels public transit monopolies

For most governments around the world, the provision of passenger transportation services, such as bus or train, is an expensive proposition. Passenger transportation subsidies seem to be an entrenched fact of life - one that few governments have had the courage to challenge.

In 1989, the New Zealand government decided to tackle the problem by changing the way it gave out passenger transportation subsidies. It amended its Local Government Act to achieve more value for money spent by city and local governments. To qualify for central government subsidies from Transit New Zealand, the

government agency that funds the country's road and transit systems, cities had to convert their passenger transport services and public works operations into companies called Local Authority Trading Enterprises (LATEs). These LATEs were then required to compete with private companies for the right to provide municipal services.

LATEs can remain in service only if they are competitive with the private sector. The risk of losing a contract to provide local services has forced many of the LATEs to be efficient.

The new policy of competition now

saves New Zealand taxpayers millions of dollars each year. The need to focus on value for money has forced cities to rethink what activities they should be directly involved in.

The City of Wellington recently decided to get out of the passenger bus business. It generated new money without increasing taxes by selling its bus and trolley system for \$6.5 million. The city now contracts for bus service from the market place and saves 20% of the cost of the old city monopoly transit system.

Some cities have achieved even greater savings. For example, the city of Christchurch cut transit costs by 30% in the new competition-oriented world of New Zealand local services. In addition, the New Zealand Railways Corporation sold its Intercity Bus division to a co-operative of bus operators for \$17.5 million.



Private bus companies compete for city bus routes. New Zealand taxpayers save 20 to 30%.



Fiona Knight, Manager of Policy and Planning at Transit New Zealand - competitive pricing procedures force efficiency.

## New Zealand civil service: Pay now based on performance

Convinced that the bureaucratic system wastes resources, the New Zealand Labour government made major changes to the civil service. Don Hunn has been in charge of the New Zealand State Service Commission since 1981. The Commission, like Canada's federal and provincial governments' public service

commissions, was responsible for negotiating staffing, pay and benefits for all government departments and agencies until 1989. Mr. Hunn has overseen major changes in government personnel policies since 1984. The following is an interview Peter Holle had with Don Hunn:

**Holle:** Why did New Zealand change the way its civil service operates?

**Hunn:** The 1984 Labour government started making changes to the civil service because it felt the bureaucratic system was wasting resources.

Before, departments had poorly defined goals and objectives. Political considerations often overrode efficiency considerations. For example, the Forestry department had 7 or 8 purposes in life. It had to conserve the forest resources while selling forest resource at the same time. It was also a convenient large make-work project where the government could employ up to 5,000 people at the same time. It lost a lot of money. To make it perform more efficiently, the government determined that it should function as a business operation and corporatized it (turned it into a business oriented, self supporting state owned enterprise).

**Holle:** What changes did the government make?

**Hunn:** The New Zealand civil service went through two stages of reform.

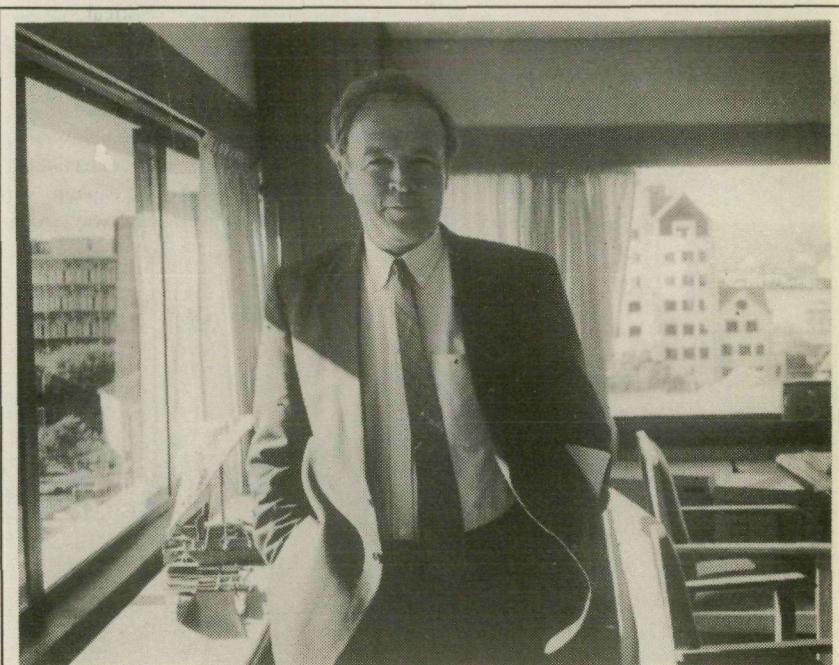
Phase one reform took activities which could be done commercially out of the bureaucratic system and restructured them into nine new business organiza-

tions (corporations) with clear commercial objectives. Some of them were then privatized.

The second phase of reform affected the remaining core departments and agencies. The 1988 changes gave government managers the freedom to manage their staff resources more effectively without central involvement of the commission. The government created a

decentralized and deregulated staffing system where employment and pay were tied to how well departments perform. Department Chief Executive Officers now have freedom to make staffing decisions within their own budgets.

**Holle:** What is the standard contract arrangement for government employees?



*Don Hunn, "The system had to change" - The government now employs people on 2 or 3 year renewable performance contracts.*

**Hunn:** Government departments now employ people on two or three year renewable performance contracts.

**Holle:** With departments free to directly negotiate pay, staffing and benefits, what is the State Service

*Commission's role now?*

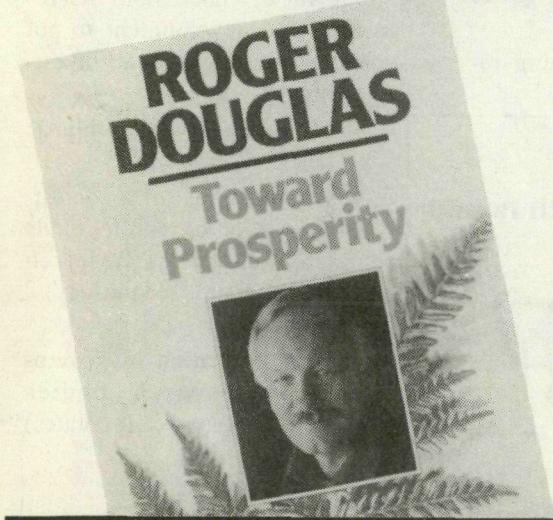
**Hunn:** The State Services Commission now functions as an advisory agency. Central bargaining for wages and benefits ended in 1989. It was responsible for negotiating salaries and benefits for about 80,000 government employees

before. With transfers to the state-owned enterprise sector and restructuring there are now about 40,000 central government employees. The Commission is directly responsible for negotiating the contracts for about 860 employees. The system is still evolving.

## Roger Douglas'

# Toward Prosperity

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# New Zealand deregulates

To make itself more competitive and increase economic growth, the New Zealand government removed hundreds of regulations that were holding back economic growth in that country. The following is an overview of some of the changes.

## Finance Industry

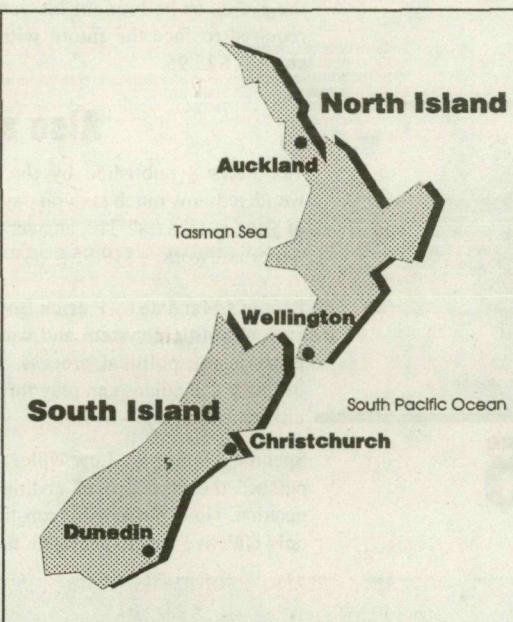
- Abolition of credit growth guidelines - 1984
- Removal of separate requirements for trustee banks, building societies, finance houses, and stockbrokers - 1985-87
- Removal of entry barriers to banking - 1985-86
- End of formal financial controls (reserve ratio requirements, sector lending priorities) - 1985
- Removal of interest rate controls - 1984
- Abolition of export credit guarantees - 1984
- Removal of ownership restrictions on financial institutions - 1985
- Liberalization of stock exchange - 1986

## Energy Industry

- Corporatization of state coal mines - 1987
- Financial restructuring of oil refinery - 1988-91
- Legalization of oil co-ownership of service stations - 1988
- End of price control (except on gas) - 1984-88
- Sale of Crown gas exploration/distribution interests 1988-90
- Sale of other Crown energy holdings 1990-92
- Corporatization and restructuring of electricity generation transmission and distribution - 1986-91

## Transport Industry

- Removal of restrictions on road/rail carriages 1983-86
- End of quantity licensing of trucking - 1984
- Corporatization of state, rail, air, and bus service - 1982-84
- Tendering of local authority bus services - 1990-91
- Liberalization of licensing re-



- Deregulation of stevedoring industry - 1990
- Cabotage on coastal shipping - 1991

## Research and Development

- Removal of concessions for research and development to put on equal footing with all investments - 1984
- Cost-recovery of public R and D work - 1985
- Establishment of a contestable pool of public funds (Foundation of Research Science and Technology) - 1990
- Corporatization of government research bodies (Crown Research Institutes) - 1992

## Labour Market

- Some contestability in union coverage under Labour Relations Act - 1987
- Employment Contracts Act (voluntary unionism, contestable unions of any size, any arrangements for employer/employee bargaining at joint or individual level) - 1990

## Product Markets

- Termination of Supplementary Minimum Prices on agricultural products - 1984
- Agricultural tax concessions removed - 1985
- Termination of concessional financing of primary producer

stocks held by producer boards - 1986-88

- Review of compulsory producer marketing board arrangements - 1987
- Termination of domestic boards for eggs, milk, wheat - 1984-88
- Termination of export market development incentives schemes - 1984
- Phaseout of export performance tax incentives - 1984-87

## **Industry Reforms**

- End of wage/price freeze - 1984
- Removal of quantity licensing on almost all industries, and end of quality regulation on most - 1986-88
- End of state regulated monopoly rights (except letter post, air traffic control, and milk distribution) - 1984-89
- Removal of some occupational licensing - 1985-90
- Removal of producer co-operative tax advantages - 1989
- Termination of restrictions on shop trading hours - 1989

## **Business Law Reforms**

- Establishment of Commerce Act as liberal efficiency-based regime to govern mergers and trade practices - 1986
- Fair Trading Act governs consumer rights - 1986
- Review of securities legislation and takeover law (extent of efficiency approach still under discussion) - 1988-91
- Review of whole intellectual property regime (Patent, Copyright, Trademarks and Designs Acts) - 1990-91
- Review of Town and Country Planning - 1987-90
- Resource of Management Act to govern more liberal planning and environmental legislation - 1991

- Crown Minerals Act to clarify property rights to mineral resources - 1991

## **Import Protectionism**

- Phasing out of import licensing requirements - 1983-89
- Reduction of import tariffs from average 28% to 10% - 1986-92
- Further one-third reduction in import tariffs planned - 1992-96
- Removal of special protection features for 18 specific industry plan sectors and incorporation into general tariff reform program - 1984-92

## **International Capital Controls**

- Removal of controls on outward investment/borrowing - 1984
- Freer entry of foreign direct investment - 1985, 1989

## **Exchange Rate**

- Deregulation of foreign exchange trading - 1984
- Devaluation of 20% against basket of currencies - 1984
- Free float of currency on foreign exchange markets without direct control - 1985

## **Monetary Policy**

- Target of 'price stability' (0-2% price increase) by 1992/93 - 1989
- Tight monetary policy, growth of money supply below rate of inflation - 1987+
- Independence of Reserve Bank from government - 1989

## **State Trading Operations**

- Removal of almost all state regulated monopoly rights - 1984-89
- Corporatization of 24 state-owned enterprises (in transport, finance, tourism, forestry,

broadcasting, utilities, and service industries) - 1987-88

- Restructuring of state-owned enterprises to remove their market monopolies - 1989-91
- Full or partial privatization of Air New Zealand, Bank of New Zealand, Petroleum Corporation, Tourist Hotel Corporation, Shipping Corporation, Rural Bank, Government Life, Forestry Corporation, Post Office Bank, Telecom Corporation, and others - 1987-91
- Further privatization planned through asset sales, sale of rights, share sales, etc. - 1991+
- Requirement for local authorities to corporatize Local Authority Trading Enterprises (LATEs) and tender out services - 1990-91
- Local authorities encouraged to sell holdings in airports, port companies and local utilities - 1991
- Some sale of assets such as irrigation schemes, fishing rights - 1983-88

## **Expenditure Control**

- Reduction in government expenditures, especially in areas of administrative and industry developments - 1985+
- Assignment of proceeds of sale of state-owned enterprise assets to repay public debt - 1987+
- Public sector management reform through Public Finance Act - 1989
- Reform of core government departments on corporate lines through State Sector Act 1988, with separation of policy, provision and funding - 1986+
- User-pay principles established for remaining state trading activity - 1986+
- Redesign of government accounts on more commercial ba-

sis, accrual accounting, and performance-based monitoring systems through Public Finance Act - 1988

- Abolition of 50 quasi-governmental organizations - 1987
- Renewed attempt at reduction in social spending (education, health, social welfare, superannuation) - 1991

### Taxation Reforms

- Broadened tax base through 'Goods and Services Tax' on virtually all final domestic consumption, without exceptions (rate now 12.5%)
- Flattening and lowering of personal income tax rate, with top

tax rate standardized to corporate tax levels, with measures to minimize impact on low income earners - 1988

- Standardization and simplification of corporate taxation to minimize evasion and cut administrative costs - 1985
- Removal of most indirect taxes - 1986-91
- Removal of tax concessions such as for savings - 1987

### Social Services Reform

- Reform compulsory education system, based on elected boards of trustees - 1988-90
- Post-secondary educational institutions partially corporatized -

1992

- State housing assistance tied to private sector rental and mortgage provision - 1991
- Tightening of requirements and reduction of levels of unemployment benefits and other government social transfers - 1990
- Tightening of requirements, extension of age, and reduction of benefits for government funded old age pension scheme - 1989-91
- Separation of funding from provision of state health services, establishment of Crown Health Enterprises - 1992
- Likely development of private funding arrangements for health services - 1992

## Bright future for New Zealand dairy farmers

When subsidies to New Zealand's farmers were eliminated in 1984, many predicted the country's agricultural base would be ruined. Despite those fears, however, New Zealand agriculture con-

tinues to be a strong engine of the economy, and New Zealand farmers are among the most competitive in the world, beating out heavily subsidized operations in Europe and North America.



New Zealanders say that when subsidies were removed in 1984, more farms survived than was initially expected. In fact, it was the family farms (not the large corporate farms) that most easily made the adjustment.

Now, while farmers in other countries are facing production and income cuts, as cash starved governments look for ways to reduce their costs, New Zealand farmers are poised to cash in on their hard won competitiveness.

One example of this new found strength is the country's dairy industry. While New Zealand only accounts for 1.5% of the world's milk production, fully 25% of international trade in dairy products comes from this country -- this despite the fact that New Zealand dairy products are excluded from most of the world's major markets.

Now the New Zealand Dairy Board is projecting that export sales of dairy products will increase from \$2.2 billion this year to \$3.5 billion in 1997 -- a 50% increase. (The farmer-owned board markets all of the country's dairy products.)

What has this meant to the average New Zealand dairy farmer? For one thing, their incomes are rising steadily, with an average income of NZ \$39,054 in 1992-93. And the future has never looked brighter. - (source Western Producer)

# Lessons from New Zealand

## How to cut costs of government departments and agencies

- New Zealand holds government departments accountable for the resources they use.
- Departments use private sector accounting and staffing practices to measure performance.
- Departments must define precisely what they do and how much it will cost to do it.
- Managers must choose between "offering" a service in house or buying it from outside suppliers. The threat of buying from the outside places downward pressure on the cost of services.
- Managers have responsibility for their staff. They have freedom to hire and fire like private sector managers.
- New Zealand measures how efficiently departments provide services and manage assets. This system favours efficient managers, not those who overspend their budgets.
- New Zealand government departments have the freedom to buy and sell assets within limits. The government places an interest charge on department assets. This encourages departments to dispose of land and assets that don't generate a return.
- Central agencies such as the State Services Commission (Public Service Commission in Canada) and Treasury no longer get deeply involved in the affairs of departments and agencies. They now require less staff.

## How to cut the cost of municipal government

- Government services organized as monopolies cost the taxpayer more money.
- NZ legislation requires local govern-

ments to reorganize local services like garbage collection and mass transit into businesses. These must compete with private companies for service contracts.

- Competition forces prices down, saving city taxpayers 20 to 30%.
- Provincial governments should tie municipal grants to strict requirements for cities to competitively tender out services.

## How to cut the cost of farm inputs

- New Zealand no longer focuses on supporting farm prices. It helps farmers with policies that cut input costs and control inflation.
- When the government got out of the subsidy game, farm costs fell, and farmers diversified into other activities.
- NZ cut transport costs for farmers by deregulating its ports, the railways, and road transport system.
- It lowered farm costs further by winding down or eliminating tariffs on agricultural machinery and other inputs.
- NZ downsized its agriculture department. What was left had to compete for business with private sector consultants.

## How to control the cost of Health care

- New Zealand contracted out catering, cleaning, laundry, and printing services previously done by hospital staff. This reduced costs by 20%.
- It restructured various other activities including grounds maintenance, engineering, payroll services at hospitals and reduced labour costs by 30 to 60%.
- New Zealand plans to control health

care costs by introducing competition into health services. Independent boards will purchase health care services from the marketplace. The government has "corporatized" hospitals and now requires them to operate using business methods. Hospitals will have to compete with the private sector for state contracts.

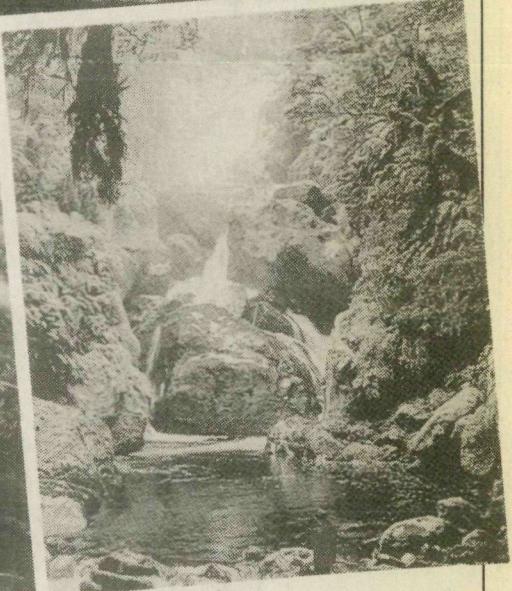
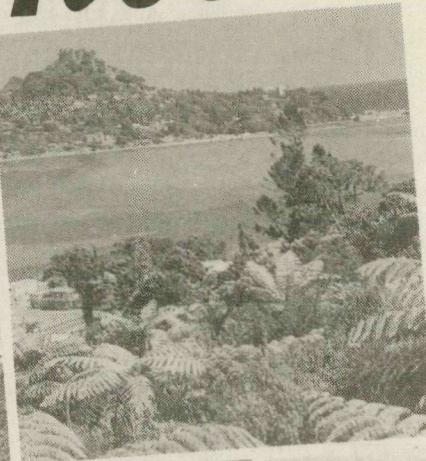
## How to cut the cost of economic development spending

- After losing billions, New Zealand politicians acknowledged they have no special talent for creating or managing businesses.
- The government is completely out of the incentives, grants, and business handout game.
- The country attracts investment by having a favorable business environment.

## How to cut the cost of crown corporations

- New Zealand eliminated huge subsidies that were propping up overstaffed and inefficient government enterprises by privatizing state-owned enterprise where possible.
- Privatization lowered New Zealand's debt. It lowered prices, improved service, encouraged new technology and made the economy attractive to investors. New investment is creating unsubsidized jobs to replace the subsidized jobs lost when the government privatized various enterprises.
- Government enterprises still owned by the New Zealand government (the SOEs) are required to pay their "fair share". Unlike many Canadian crown corporations, they pay taxes and full interest on the capital invested in them and receive no subsidies.

# *New Zealand* **Experience**



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